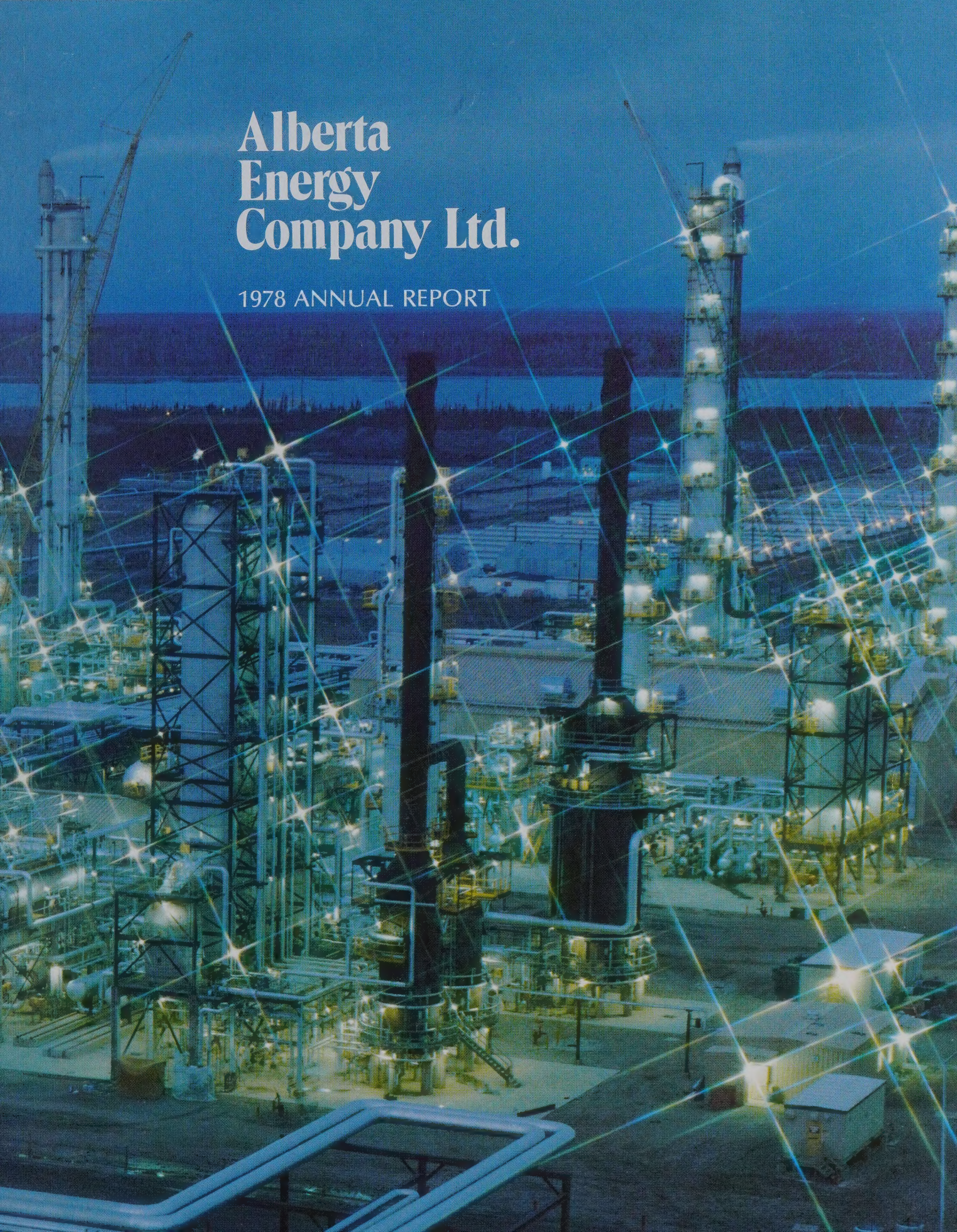
Alberta Energy Company Ltd.

1978 ANNUAL REPORT



OIL SANDS PIPELINE
100% Ownership
- $78 million invested in a 270-mile, 22-inch pipeline which transports oil from the Syncrude plant to Edmonton.

FORESTRY
40% Joint Venture Ownership
- $28 million lumber manufacturing facilities and 1.4 million acres of timber resources.

COAL
25% Joint Venture Ownership
- A $92 million thermal coal project with sales contracts for 2.5 million tons per year.

SYNCRUDE UTILITIES PLANT
66⅔% Ownership
- A $262 million plant which provides 260 megawatts of electrical energy and steam to power the Syncrude facility.

PRIMROSE OIL AND GAS RIGHTS
- $58 million committed for this 2,000-square-mile area with petroleum and natural gas potential.

ETHANE GATHERING SYSTEM
33⅓% Joint Venture Ownership
- A $48 million, 550-mile pipeline and salt cavern storage system to transport and store ethane.

SUFFIELD GAS AND OIL PRODUCTION
- $142 million invested in this 1,000-square-mile area, currently the Company's principal asset and major source of income.

HIGHLIGHTS

	1978	1977
FINANCIAL		
Net Earnings	**$ 18,786,000**	$ 14,857,000
Per share	**$1.24**	$0.98
Cash Flow	**$ 30,493,000**	$ 17,112,000
Per share	**$2.02**	$1.13
Long-term Debt	**$209,216,000**	$ 44,558,000
Working Capital	**$141,033,000**	$ 15,495,000
Total Assets	**$504,139,000**	$273,291,000
PRODUCTION		
Gas, billion cubic feet	**27**	18
Per day, million cubic feet	**74**	49
Oil, thousand barrels	**153**	88
Per day, barrels	**420**	241
Coal, thousand short tons	**173**	—
Lumber, million board feet	**44**	28

- Net earnings per share increased by 26% and cash flow was up 78%.
- $300 million bank credit facility arranged.
- 1.3 million acres of petroleum and natural gas rights acquired at Primrose. Geophysical and drilling activity commenced.
- 397 gas and oil wells drilled at Suffield in 1978.
- First cash flow received from the Syncrude Utilities Plant and the Alberta Oil Sands Pipeline.
- Coal Valley facilities completed and first coal revenue received.

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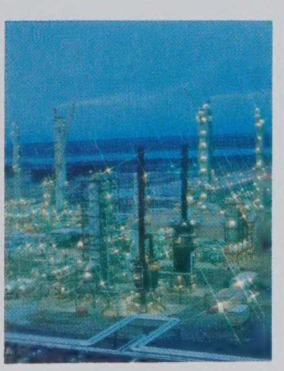


COVER PHOTO
AEC Power's Utilities Plant provides the steam and electricity to operate the Syncrude facility, depicted on the front cover.

PRESIDENT'S REMARKS

1978 has been another good year for AEC. The steady growth shown in our previous three years of operations has continued, with increases of 78% in cash flow and 26% in net income. Year-end working capital was $141 million.

1978 also saw AEC building for the times ahead. The Company acquired 2,000 square miles of petroleum and natural gas rights in the Primrose military range, which are now undergoing initial evaluation and showing promising potential. The Company also enhanced its base for future developments by establishing a $300 million credit facility with commercial banks using our Suffield gas for collateral. These achievements, added to results from further drilling at Suffield and developments in other ongoing projects, have produced a very favourable outlook for AEC.

AEC has a unique structure and many shareholders who have never before owned shares of any corporation. It became a public Company in late 1975 when $75 million in shares were offered for sale to the public, matching an equal investment by the Province of Alberta. Today, AEC remains wholly Canadian-owned; 95% of our more than 50,000 shareholders are Albertans, about 85% own 100 or fewer shares, and 51% own 30 shares or less.

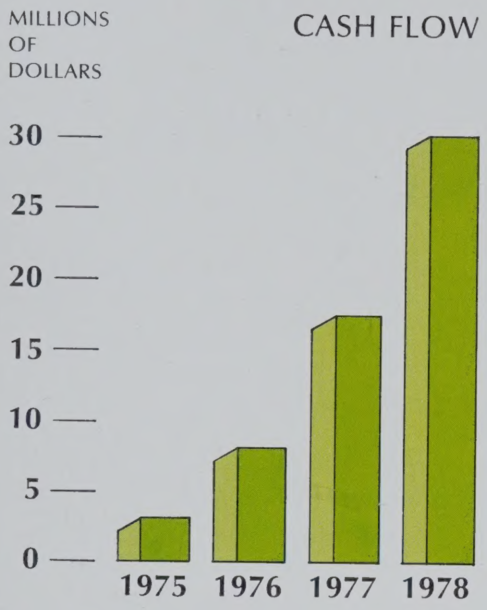
These days, much of an annual report is in such specialized language and format that the data is less than helpful to the average investor in spite of reporting "ground rules" which have been developed to better inform and protect shareholders. The following overview of the Company's position will be presented as directly and non-technically as possible.

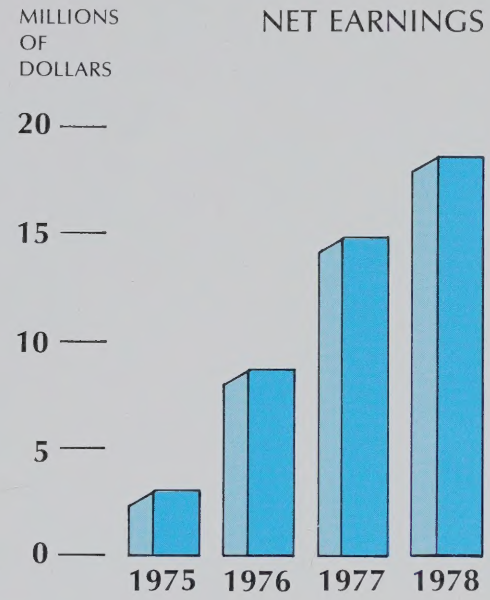
Some aspects of AEC's operations are not readily apparent on the financial statements. You will note that this Company's biggest asset, 1.6 trillion feet of gas at Suffield, does not even appear on the Balance Sheet. Here is another item: if AEC is paid for gas that a buyer has contracted to purchase but does not wish to take because of lack of demand by the buyer's customers, the money AEC receives does not show immediately in net income. Happily, however, this cash does actually appear in our bank account. Another illustration: the $235 million borrowed by a subsidiary, AEC Power, for the Syncrude Utilities Plant, does not show on the AEC Balance Sheet. (Repayment of this plant debt is assured by two governments and four large oil companies.) These items illustrate how difficult the reporting rules make it for a non-technical investor to follow what is happening in a corporation. For AEC, I can say plainly that what is happening to the Company in total is very good, indeed. Sometimes one indicator of progress is the share price, which has doubled in slightly over three years. Professional analysts and investors are assessing AEC very favourably.

AEC, like other Canadian corporations, is taxable, and only our after-tax dollars can be used to provide shareholders with a return on their investment. Corporations do not enjoy paying taxes any more than individual wage-earners, even though corporate taxes are ultimately paid by that recipient of all tax demands — the average consumer. Because of AEC's exceptionally high rate of investment in various projects, it has been able to defer tax that would be payable otherwise. Deferred tax, which shows on the income statement, is an accounting entry to show the amount of tax that will be payable in the future. If the Company keeps investing at the present pace, no taxes will be payable for many years.

Here, in capsule form, are comments on our principal activities:

- **At SUFFIELD Military Block** — development is ahead of schedule and excellent take-or-pay gas sale contracts are in place. There has been a fine effort here by staff, with nearly 1,000 gas and oil wells drilled and $142 million invested. Reserves of gas are about the same as a year ago. Productivity is a bit higher than expected, so fewer wells are needed at the moment. After an unusually high success ratio for deeper tests in the northwest portion of the Block, not much has been found in the last two major farmouts, on the eastern portion. An excellent co-operative relationship between AEC and the Canadian Armed Forces permits energy development and military activity to proceed simultaneously; the efficiency of our Canadian military forces has been most impressive.
- **At SYNCRUDE** — the Utilities Plant and the pipeline are performing well, at a profit. There are some start-up problems for the entire Syncrude operation but, helping to offset this, current crude price is slightly higher than we expected. Our final decision to exercise part or all of the option on the entire Syncrude Plant will not be made until near the expiry of the option on September 1, 1979. It is likely that the Company will exercise at least a part of the option. Estimated price on the full 20% would be $580 million. If AEC becomes a plant owner, there could be further, voluntary investment in plant expansion, which would require more capital. A decision to exercise a major portion or all of this 20% option is neither small nor easy, because of its magnitude and its possible initial adverse impact on earnings.





- **At PRIMROSE** — evaluation of this 2,000-square-mile military block is just underway. Initial results have been very encouraging, with some gas finds and indications of heavy oil potential being encountered in the first few wells.
- **At COAL VALLEY** — cash flow has started. Some start-up problems are occurring and are being handled well. This looks like a venture that will be successful.
- **At WHITECOURT** — a net profit was achieved in 1978 from this forestry operation, which is very good for a new facility of its type. Higher-than-expected operating costs have been offset by better lumber prices. The cheap Canadian dollar has been a positive factor in our sales picture. As with so many Alberta projects, the stability and cost of the work force will be of great importance in the years ahead.
- **The ETHANE LINE** — is doing well. It is operating at a profit.
- **At WILLOWGLEN** — a new Chief Executive Officer has been appointed. Willowglen has undergone reorganization and has the potential to turn the corner and make a profit, which it did not do in 1978.
- **At STEEL ALBERTA** — work continues on developing an economically viable steel investment in Western Canada, and Steel Alberta's IPSCO shareholding shows a good profit.
- **At PETALTA** — the benzene project is moving ahead, although we would like to see the pace accelerated. Application has been made to construct a synthetic natural gas plant in conjunction with the benzene facility. While much remains to be done before the plans can become a certainty, progress has been encouraging to date. AEC has received indications that other companies experienced in the petrochemical business are seriously interested in participating in this benzene plant.

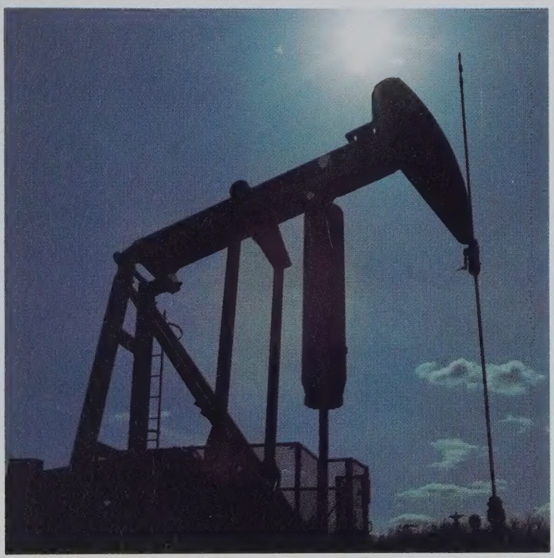
Throughout AEC, work continues on other ventures suitable for investment. As shareholders are no doubt aware, most investments take time to mature to a point where significant cash-flow is achieved. At year-end 1978, for example, an estimated $59 million was invested by AEC in projects that have not yet reached such maturity but which are fully expected to yield good income in the years ahead.

To year-end 1978, the Company's fourth year of operation, progress has been good. The outlook is for further gains in cash flow and net income in 1979. For this, thanks are due to a very fine hard-working staff and exceptionally capable Board of Directors. The outlook for AEC this year, and for the foreseeable future, is very favourable indeed.

David E. Mitchell
President

GAS & OIL

SUFFIELD


Oil well pumper

1978 was an active year at the Suffield Military Block near Medicine Hat, a 1,000-square-mile area in which 991 gas and oil wells have been drilled to date. Gas is flowing from the field to markets in Alberta, other parts of Canada and the United States.

Suffield, the Company's principal asset, is the largest petroleum development area under one operating management in the Canadian oil and gas industry.

Shallow Drilling — During the year, 363 shallow gas wells were drilled bringing the total to 897. Six hundred and fifty-one gas wells have been connected to producing systems, and construction of facilities to connect newly-drilled wells is continuing. Approximately 180 miles of lease roads and 723 miles of gathering system had been completed at year-end.

Deep Drilling — The deep drilling programs (below 2,200 feet) are carried out by other companies under farmout agreements. During the year 117 deep wells were drilled yielding 6 gas wells, 19 oil wells and 9 dual-zone oil and gas discoveries. Deep drilling successes to year-end totalled 94 wells, of which 26 are gas wells, 31 oil wells and 37 dual-zone oil and gas discoveries.

Gas Sales — Gas sales contracts provided for a minimum take-or-pay obligation of 109 million cubic feet per day at the end of 1978. These contracts provide for increasing take-or-pay obligations as development progresses. The Company has firm take-or-pay contracts in place for all the shallow gas developed to date or expected to be developed over the next several years, plus the deep gas now developed in the northwestern portion of the Block.

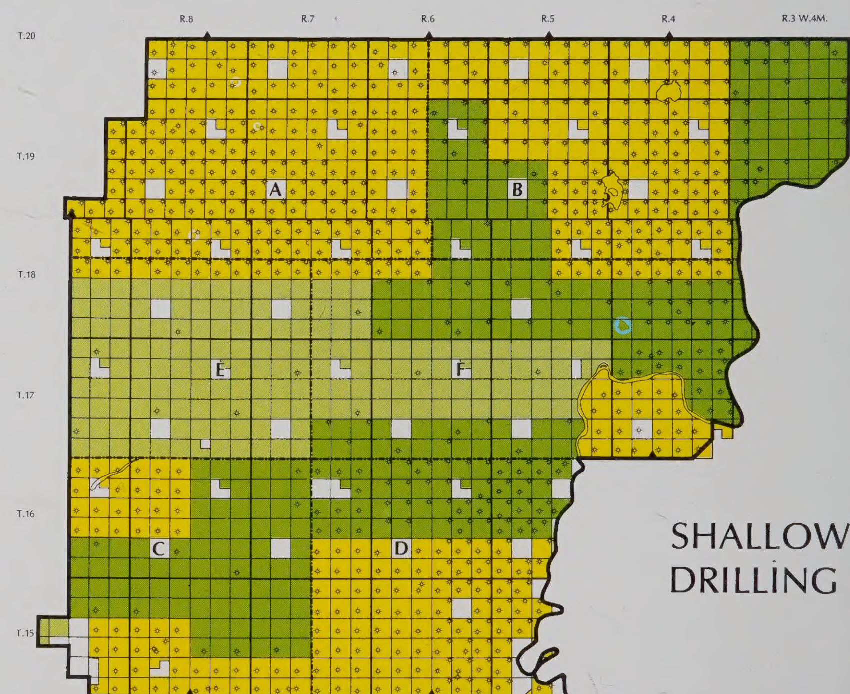
Reserves — Total proved and probable gas reserves remaining after production to date are estimated to be 1.6 trillion cubic feet, approximately the same as estimated last year. Estimates of in-place heavy oil reserves have increased to 319 million barrels, net to AEC before deducting royalties. This is an increase from 261 million barrels in the previous year, primarily as a result of minor discoveries in Areas "B" and "D".

SUFFIELD

PETROLEUM AND NATURAL GAS RIGHTS

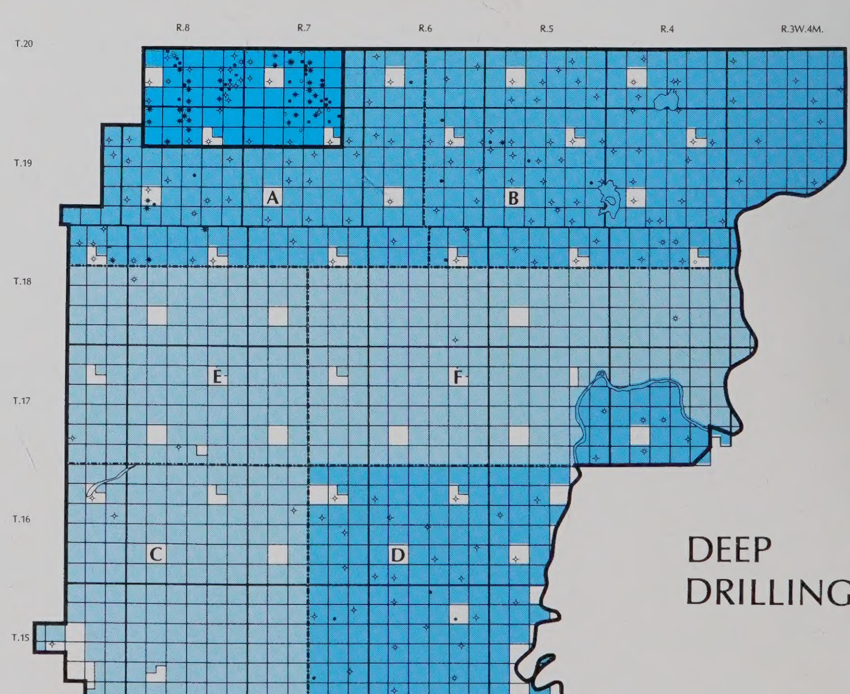
PRODUCTION AREA
CURRENT DEVELOPMENT AREA
FUTURE DEVELOPMENT AREA
P & NG RIGHTS HELD BY OTHERS
GAS WELL
COMPRESSOR STATION

MILES
0 1 2 3 4 5 6



SPECIAL OIL PRODUCTION AGREEMENT AREA
FARMED-OUT AREA
FUTURE EVALUATION AREA
P & NG RIGHTS HELD BY OTHERS
GAS WELL
OIL WELL
OIL-GAS WELL
DRY AND ABANDONED

MILES
0 1 2 3 4 5 6



Right: Gas gathering system construction at Suffield

Below: Suffield pipe unloading

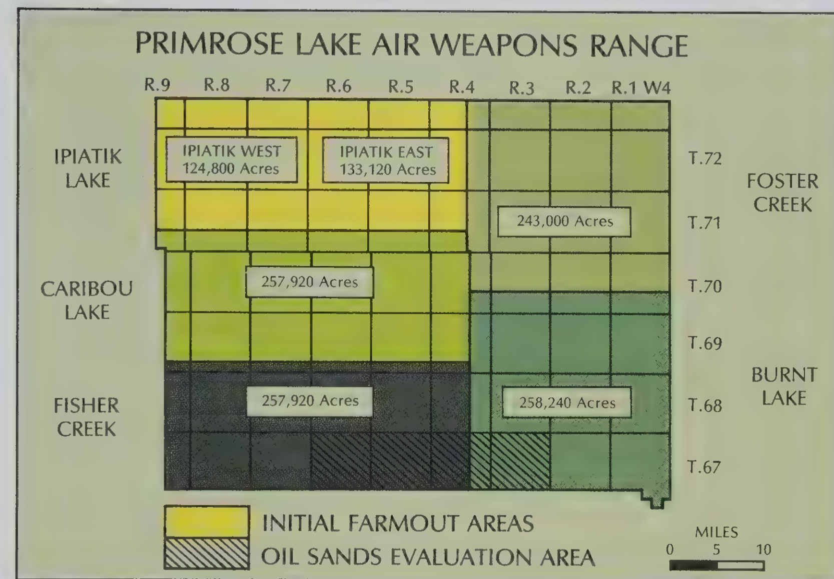
Estimated recoverable oil at Suffield, net to AEC before deducting royalties, is 7 million barrels, using conventional production methods. The Company, in a joint venture with others, plans to initiate a $9 million experimental combustion project in 1979 to obtain information that may be applied to the Suffield heavy oil pools to increase the quantity of oil that can be recovered.

PRIMROSE

The Company's most recent investment in oil and gas has been the acquisition of petroleum and natural gas rights underlying another large block of military acreage in Alberta. The Primrose block is a bombing and gunnery range which straddles the Alberta-Saskatchewan border, north of Cold Lake, Alberta. The Alberta rights, encompassing a 2,000-square-mile area, were acquired for a total commitment of $57.6 million of which $32 million represents work obligations.

The pattern of co-operation developed by AEC and the military forces at Suffield will be followed at Primrose. A surface access agreement has been signed which allows energy resource development to occur while military operations continue. The agreement, negotiated with the Department of National Defence, provides access to about 20% of the Range at any one time for a five-year period for evaluation and development purposes. The agreement also provides access to the Range for operation of all wells and facilities needed to bring any oil or gas discoveries into production.

PRIMROSE



Unlike Suffield, the Primrose Range has had no significant evaluation drilling, but the Company believes it has potential for both natural gas and heavy oil development.

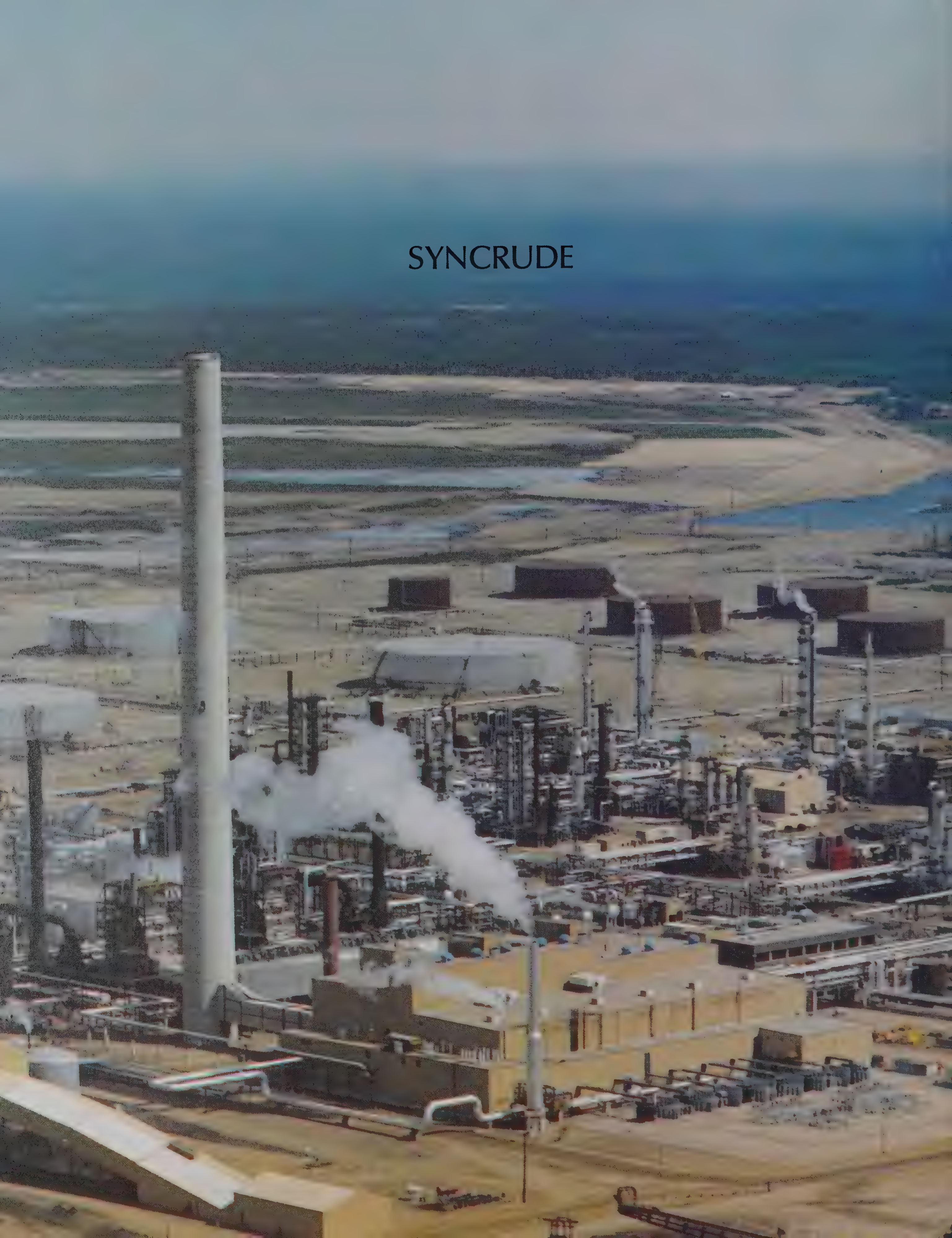
Seismic surveys and evaluation drilling have commenced in the northwest portion of the Range, where AEC has farmed out two areas comprising approximately 200-square-miles each. Three oil companies have committed to drill 172 evaluation wells and conduct extensive geophysical surveys. The companies will expend some $32 million in carrying out their programs. In one of the 200-square-mile areas, the farmees will earn a 50% working interest with AEC retaining 50%, and in the other area, AEC will retain a 50% to 75% working interest depending on how the follow-up expenses are shared.

At the time of going to press, 34 wells had been drilled in the northwestern portion of the Range. The results have been very encouraging, with 5 wells encountering gas, 7 encountering heavy oil sands, and 15 encountering both gas and heavy oil sands. Application has been made to proceed with a preliminary heavy oil sands evaluation program in four townships in the southern part of the Range, and work on this program is expected to commence in late 1979.

Drilling at Primrose

Heavy Oil — AEC is assessing opportunities in heavy oil production and the construction and ownership of facilities that may be required for recovering, processing, and transporting heavy oil.

SYNCRUDE



AEC POWER LTD.

Above: Interior of Utilities Plant
Left: AEC Power's Utilities Plant

AEC Power's Utilities Plant, now fully operational, is providing the steam, electric power and processed water required to operate the Syncrude mining, extraction and upgrading facilities.

The Utilities Plant, which took 4 million man-hours of labour to complete, produces about 260 megawatts of electric energy — enough to supply a city of over one-quarter of a million people.

Cash flow is being received for the first time from this $262 million Utilities Plant.

Future heavy oil projects and oil sands plants may require similar facilities, and it is anticipated that AEC will participate in providing these essential services.

SYNCRUDE OPTION

AEC is currently evaluating its option to purchase a participating interest of from 5% to 20% of the Syncrude project.

If the Company should exercise all or a portion of this option, the cost would range from $145 million to $580 million.

By any corporate standard, the Syncrude option decision is major. As well as having immediate and long-term effects on Company earnings and future financial ability, it represents a very large single-risk investment.

At the time of report preparation, the Company is seriously considering exercise of at least part of the option, and a final decision will be made by September 1, 1979.


COAL

Right: *Unit train transporting coal*
Below: *Electric coal shovel*

Construction of the Coal Valley project was completed and coal sales commenced in 1978. This $92 million project is capable of producing two and one-half million tons of coal per year which has an energy content equivalent to 26,000 barrels of oil per day.

An interesting and unique feature of the Coal Valley project is the helicopter transportation system used for the movement of the work force. From home base at Edson, mine employees are airlifted to and from the site by a 32-passenger helicopter. The plant runs 3 shifts per day, 24 hours a day, 7 days a week.

For the first time, Alberta thermal coal is being shipped to Eastern Canada to power generating stations and is also being shipped to off-shore customers. Every year, two million tons of high-grade coal will travel from Coal Valley by unit train to Thunder Bay and from there by lake freighter to its final destination — a thermal generating station in Ontario. In addition, one-half million tons of coal per year will travel from Coal Valley to Vancouver, destined for markets in Europe.

The Company is investigating other investment opportunities in the coal industry.

PIPELINES

ALBERTA OIL SANDS PIPELINE LTD.

Above: Helicopter patrol, remote control centre and pipeline alley.

The Alberta Oil Sands Pipeline is carrying synthetic crude oil produced by the Syncrude plant to Edmonton. Financing arrangements have been completed and revenue is being received from the pipeline.

With an initial design capacity of 163,500 barrels per day, the pipeline is capable of moving both the current production and the output at the Syncrude plant's full design capacity. As well, the pipeline's capacity could be increased to serve other oil sands plants in northeastern Alberta.

AEC expects to finance and operate other oil pipelines for heavy oil facilities elsewhere in Alberta.

ETHANE GATHERING SYSTEM

The 550-mile pipeline system for gathering ethane from gas plants at various points in Alberta is now operational.

A portion of the ethane will be transported to an ethylene-upgrading facility in the Province, and the remainder shipped to Eastern Canada.

This $48 million system, which operates on a cost-of-service basis, has a capacity of 76,000 barrels per day. As part of the transportation system, salt cavern storage for excess ethane in the amount of 500,000 barrels has been developed at Fort Saskatchewan.

FORESTRY

The lumber manufacturing facility at Whitecourt yielded a profit in 1978, and operations at the level of design capacity — 100 million board feet per year — were regularly achieved. The market for lumber remained strong throughout the year.

During 1979, considerable attention will be given to the continued development of facilities in the Whitecourt area.

AEC is continuing to seek additional investments in forestry.

OTHER ACTIVITIES

Steel Alberta Ltd. — a Company evaluating the feasibility of developing a viable steel industry in Western Canada. As well as its 20 percent interest in Interprovincial Steel and Pipe Corporation Ltd., iron ore deposits in Alberta and Montana have been obtained containing over one billion tons of proved and probable reserves. Extensive market surveys of the steel industry have been commissioned, and proposals are being evaluated for projects such as iron ore mining, basic steelmaking and rolling facilities, major product fabrication and manufacturing.

Pan-Alberta Gas Ltd. — a Company actively involved in the marketing of natural gas produced in Alberta. Pan-Alberta is currently selling gas for consumption in Alberta, Quebec, Saskatchewan and the Pacific Northwest. Applications have been filed with the Energy Resources Conservation Board for a permit to remove 6.4 trillion cubic feet of gas from Alberta to other parts of Canada and the United States.

Petrochemicals Alberta Project (PETALTA) — has obtained an Industrial Development Permit to build a world-scale benzene plant. In conjunction with this project, AEC has submitted applications to the Energy Resources Conservation Board for an authorization to convert the by-products from the manufacture of benzene to synthetic natural gas and to remove it from the Province of Alberta.

Willowglen Company Limited — a high-technology Canadian electronics firm which specializes in the design and manufacture of electronic process control equipment. In 1978, the Company provided equipment for a number of projects, including pipelines, gas field monitoring and electric utilities.

1978 FINANCIAL REVIEW

Net earnings were $18,786,000 or $1.24 per share, 26% more than the 1977 earnings of 98¢ per share. Cash flow was $30,493,000 or $2.02 per share, up 78% from the 1977 cash flow of $1.13 per share.

Production of gas and oil from the Suffield Block continues to be the largest contributor to revenues and earnings. Revenue from gas and oil, after payment of $13,600,000 in royalties to the Province, totalled $28,200,000.

AEC invested more than $90 million during 1978 in property, plant and equipment. This includes $37 million for Suffield Block development, $26 million for acquisition of Primrose Range rights, and $22 million in completing construction of the pipeline systems.

AEC's share of 1978 income from AEC Power, two-thirds owned, is based on a provisional rate of 15% on its equity investment. The exact rate will be determined soon by arbitrators and must be between 13% and 22%. The difference, if any, between the percentage set by arbitrators and the 15% provisional rate, will be retroactive to April, 1976, and will be recorded as a charge or credit to income in 1979. Each 1% difference between the provisional rate and the determined rate will result in an adjustment of approximately $600,000 to AEC's 1979 income.

During the 1978 gas contract year, certain of AEC's customers were unable to take some portions of the minimum quantities stipulated under the related gas contracts. As these customers are required to pay for such gas not taken with the option of taking the related quantities of gas over the next several years, all such payments are reflected as deferred revenue. The amounts deferred will be taken into income as the customers take the underlying quantities of gas or when it is known that the customers cannot take such gas, whichever occurs first.

AEC has arranged a credit facility with two chartered banks which provides for up to $300 million to be drawn in the form of loans or income debentures. On November 15, 1978, income debentures totalling $150 million were issued. The tax treatment of these debentures is subject to the receipt of a favourable income tax ruling. This debt has a primary term of up to ten years and is repayable over a ten-year period thereafter. It is secured by Suffield Block reserves as well as a fixed charge on the related production equipment and an assignment of the related gas sales contracts.

In 1978, Alberta Oil Sands Pipeline Ltd. issued a further $16.5 million of Series B First Mortgage Sinking Fund Bonds, the proceeds being used to complete its system and to provide for line-fill. AEC Power Ltd. issued $55 million of United States dollar series of First Mortgage Sinking Fund Bonds in 1978 to complete the construction of the Utilities Plant which serves the Syncrude Project.

FINANCIAL STATEMENTS

AUDITORS REPORT

To the Shareholders of
Alberta Energy Company Ltd.

We have examined the consolidated balance sheet of Alberta Energy Company Ltd. as at December 31, 1978 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination of the financial statements of Alberta Energy Company Ltd., its subsidiaries and the affiliate of which we are auditors was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. We have relied on the reports of other auditors who have examined the financial statements of the other affiliates and the joint ventures.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1978 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PRICE WATERHOUSE & CO.

Chartered Accountants
Edmonton, Alberta
January 29, 1979

CONSOLIDATED BALANCE SHEET

ASSETS

	December 31 1978	1977
	(in thousands)	
CURRENT ASSETS		
Cash and short term investments at cost which approximates market	$152,239	$ 21,371
Accounts receivable and accrued revenue	15,011	7,087
Inventories (Note 2)	2,627	1,568
Prepaid expenses	570	445
	170,447	30,471
INVESTMENT IN AFFILIATED COMPANIES (Note 3)	32,864	30,244
PROPERTY, PLANT AND EQUIPMENT (Note 4)	290,765	206,618
OTHER ASSETS AND DEFERRED CHARGES (Note 5)	10,063	5,958
	$504,139	$273,291

LIABILITIES

	1978	1977
CURRENT LIABILITIES		
Bank loan	$ 14,350	$ 716
Accounts payable and accrued liabilities	12,027	12,910
Current portion of long-term debt (Note 6)	3,037	1,350
	29,414	14,976
DEFERRED REVENUE	3,000	762
LONG-TERM DEBT (Note 6)	209,216	44,558
DEFERRED LIABILITIES (Note 7)	50,442	30,000
DEFERRED INCOME TAXES	18,556	8,595
	310,628	98,891
SHAREHOLDERS' EQUITY		
Share capital (Note 8)		
Authorized — 100,000,000 shares without par value		
Issued and fully paid — 15,111,851 (1977 — 15,090,976)	147,669	147,344
Retained earnings	45,842	27,056
	193,511	174,400
	$504,139	$273,291

Approved by the Board:

Director

Director

CONSOLIDATED STATEMENT OF EARNINGS

	Year ended December 31 1978	1977
	(in thousands)	
INCOME FROM OPERATIONS (Note 9)		
Gas and oil	**$19,354**	$10,709
Pipelines	**8,448**	133
Forestry	**495**	(958)
Coal	**(108)**	—
Other	**(1,260)**	(294)
	26,929	9,590
INTEREST (EXPENSE) INCOME — net (Note 9)	**(2,170)**	4,676
	24,759	14,266
GENERAL AND ADMINISTRATIVE EXPENSES	**3,652**	2,350
INCOME BEFORE INCOME TAXES AND EQUITY EARNINGS	**21,107**	11,916
PROVISION FOR INCOME TAXES — Deferred	**9,706**	5,040
— Current	**(1,000)**	(1,102)
	8,706	3,938
EQUITY IN EARNINGS OF AFFILIATES (Note 3)		
AEC Power Ltd.	**3,066**	2,747
Steel Alberta Ltd.	**1,795**	752
Pan-Alberta Gas Ltd.	**352**	1,171
	5,213	4,670
ALLOWANCE ON EQUITY FUNDS EMPLOYED DURING CONSTRUCTION	**1,172**	2,209
NET EARNINGS	**$18,786**	$14,857
EARNINGS PER SHARE	**$ 1.24**	$ .98

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

	Year ended December 31 1978	1977
	(in thousands)	
BALANCE — BEGINNING OF YEAR	**$27,056**	$12,199
NET EARNINGS	**18,786**	14,857
BALANCE — END OF YEAR	**$45,842**	$27,056

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended December 31 1978	1977
	(in thousands)	
SOURCE OF FUNDS		
Income before income taxes and equity earnings	$ 21,107	$ 11,916
Income tax	1,000	1,102
Non-cash items, principally depletion and depreciation	8,386	4,094
Funds from operations	30,493	17,112
Dividend — AEC Power Ltd.	2,011	—
Deferred revenue	2,238	(738)
Issue of share capital	325	269
Issue of long-term debt	164,658	44,558
Deferred liability	20,442	—
Advances from affiliated companies — net	653	900
	220,820	62,101
USE OF FUNDS		
Investment in property, plant and equipment		
Gas and oil	62,935	33,092
Pipelines	21,811	50,435
Forestry	542	2,159
Coal	4,369	22,843
Other	977	491
	90,634	109,020
Investment in affiliated companies	—	994
Other assets and deferred charges	4,648	4,969
	95,282	114,983
INCREASE (DECREASE) IN WORKING CAPITAL	125,538	(52,882)
WORKING CAPITAL — BEGINNING OF YEAR	15,495	68,377
WORKING CAPITAL — END OF YEAR	$141,033	$ 15,495

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1978

1. Summary of significant accounting policies

(a) Investments in other entities

Subsidiaries —

The accounts of Alberta Energy Company Ltd. ("AEC") are consolidated with those of other companies in which AEC owns more than 50% of the voting shares. These include Alberta Oil Sands Pipeline Ltd. ("AOSPL") which is wholly-owned and Willowglen Company Limited, ("Willowglen"), a 76% owned subsidiary. The results of subsidiaries are included from the acquisition dates.

Affiliates —

Where AEC owns 50% or less of the voting shares of another corporation and is in a position of exerting significant influence in the decisions made by such investees, AEC has adopted the equity method of accounting for such investments. Under this method AEC's proportionate share of the affiliates' earnings is included in income and the investment is carried at cost plus equity in undistributed earnings since acquisition.

Joint ventures —

Where AEC participates in unincorporated joint ventures, it follows the proportionate consolidation method of accounting wherein AEC's proportionate share of each of the assets, liabilities, revenues and expenses associated with a joint venture is combined with similar categories within AEC's accounts. AEC participates in unincorporated joint ventures as follows:

— Forestry — 40%
— Ethane Gathering System ("Ethane") — Pipeline — 33 1/3%
— Coal — 25%

Summarized information relating to these operations is included in Note 9.

(b) Property, plant and equipment

Gas and oil —
AEC employs the full cost method of accounting for gas and oil properties and capitalizes all costs related thereto. Petroleum and natural gas leases are situated in the Suffield Block and the Primrose Range and are being developed on an area basis. Costs associated with producing areas are amortized using the unit of production method based on estimated proven reserves. Costs associated with non-producing areas are accumulated until commencement of production.

Pipelines —
Allowances for return on equity and borrowed funds employed during construction are included in the capitalized cost of the pipelines.

Property, plant and equipment is carried at cost with depreciation provided on a straight-line basis over a period of 20 years commencing April 1, 1978 for Ethane and a period of 25 years commencing May 1, 1978 for AOSPL.

Forestry —
Property, plant and equipment is carried at cost with depreciation provided on a straight-line basis over the useful lives of the respective assets to a maximum of 20 years.

The cost of acquiring timber harvesting rights is depleted on the basis of timber cut and removed as it relates to the volume of timber estimated to be recoverable.

Coal —
The major portion of plant and equipment is being depreciated on the unit of production method based on estimated total reserves.

Preproduction costs and the cost of stripping will be amortized over 5 years commencing in 1979 whereas other assets, primarily vehicles, are being depreciated over their expected useful lives.

(c) Deferred charges

Costs incurred in investigating projects are deferred pending investment decisions. Costs of project investigations which result in investments are included in the cost of such investments. When it is determined that investments will not result, costs related to these investigations are charged against income.

Product development costs are deferred and amortized on a straight-line basis over seven years.

Financing costs are amortized in equal annual amounts over the life of the related debt.

2. Inventories

Inventories are valued at the lower of cost and estimated net realizable value. They consist of:

	1978	1977
Raw materials	**$ 789,414**	$ 411,103
Work-in-process	**1,075,665**	869,206
Finished goods	**761,941**	287,561
	$2,627,020	$1,567,870

3. Investments in affiliated companies, at equity

	AEC Power Ltd.	Steel Alberta Ltd.	Pan-Alberta Gas Ltd.	**1978 Total**	1977 Total
Common shares	$16,032,200	$ 10,000	$ 999,900	**$17,042,100**	$17,042,100
Advances — unsecured	(1,052,890)	6,059,515		**5,006,625**	5,659,515
Equity in undistributed earnings since acquisition	5,449,311	3,748,990	1,616,769	**10,815,070**	7,541,995
	$20,428,621	$9,818,505	$2,616,669	**$32,863,795**	$30,243,610

(a) AEC Power Ltd. ("AECP") (66⅔% equity interest; 50% voting interest)

AECP owns the Utilities Plant which serves the Syncrude project.

AEC's share of the return on equity invested, based on a 15% provisional rate, pending determination of the rate of return relating to the plant, has been included in income under the caption "Equity in Earnings of Affiliates".

(b) Steel Alberta Ltd. (50% equity interest; 50% voting interest)

Steel Alberta owns 20.2% of Interprovincial Steel and Pipe Corporation Ltd. and accounts for this investment on the equity method.

(c) Pan-Alberta Gas Ltd. (50% equity interest; 40% voting interest)

4. Property, plant and equipment

	1978			1977
	Cost	Accumulated depreciation, depletion and amortization	Net	Net
Producing properties				
Gas and oil (Suffield Block)				
Lease rights	$ 35,291,753	$ 2,023,287	$ 33,268,466	$ 27,441,142
Intangible development	46,770,910	2,682,032	44,088,878	24,648,962
Equipment	38,637,611	3,258,277	35,379,334	18,947,889
	120,700,274	7,963,596	112,736,678	71,037,993
Pipelines				
AOSPL	78,660,374	1,930,988	76,729,386	—
Ethane	10,400,410	468,028	9,932,382	—
	89,060,784	2,399,016	86,661,768	—
Forestry				
Plant and equipment	11,228,868	1,868,817	9,360,051	8,914,668
Timber harvesting rights	1,016,554	40,411	976,143	878,313
	12,245,422	1,909,228	10,336,194	9,792,981
Coal — Plant and equipment	27,230,269	549,129	26,681,140	—
Properties under development				
Gas and oil — Suffield	21,368,091	—	21,368,091	30,886,843
— Primrose	25,834,473	—	25,834,473	—
Pipelines — AOSPL	—	—	—	60,904,822
— Ethane	5,508,041	—	5,508,041	9,265,133
Forestry	—	—	—	919,790
Coal	—	—	—	22,843,379
	52,710,605	—	52,710,605	124,819,967
Other property, plant and equipment	2,146,779	507,903	1,638,876	967,309
TOTAL	$304,094,133	$13,328,872	$290,765,261	$206,618,250

5. Other assets and deferred charges

	1978	1977
Deposits and amounts receivable	$ 675,837	$ 594,092
Loans under Share Purchase Plans	1,166,862	901,281
Project investigation costs	4,514,466	1,657,363
Undivided 50% interest in iron ore properties	1,323,334	—
Unamortized financing costs	956,422	1,079,479
Unamortized product development costs	1,425,922	1,725,332
	$ 10,062,843	$ 5,957,547

6. Long-term debt

	1978	1977
AEC		
Income debentures	**$150,000,000**	$ —
AOSPL First Mortgage Sinking Fund Bonds:		
Series A — $9^5/_8$%, due June 15, 1997	**28,650,000**	30,000,000
Series B — $9^3/_4$%, due June 15, 1997	**31,500,000**	15,000,000
	60,150,000	45,000,000
Other	**2,102,855**	907,997
	212,252,855	45,907,997
Current portion of long-term debt	**3,036,820**	1,350,000
	$209,216,035	$44,557,997

AEC

The Company has arranged a credit facility with two chartered banks providing for up to $300,000,000 to be drawn in the form of term loans or income debentures. On November 15, 1978 income debentures totalling $150,000,000 were issued (the tax treatment of which as income debentures is subject to the receipt of a favourable income tax ruling). This debt is secured by a portion of the reserves of the Suffield Block, a fixed charge on the related production equipment and an assignment of the related gas sales contracts and is repayable in full over a period of ten years commencing not later than December 31, 1988. The interest rate on income debentures is approximately one-half of the sum of the lenders' prime commercial lending rate and a factor which varies over the term of the debentures from $^3/_8$% to $1^3/_8$%. The interest rate on term loans would be the lenders' prime commercial lending rate plus a factor varying over the term of the loans of up to 1%.

AOSPL

On June 15, 1978, $16,500,000 of the Series B — $9^3/_4$% First Mortgage Sinking Fund Bonds due June 15, 1997 were issued. Both Series A and B bonds are secured by a first and fixed charge upon AOSPL's fixed assets and a floating charge on all its other assets. Outstanding debt related to the AOSPL pipeline is guaranteed by the Syncrude Participants in the event of abandonment of the Syncrude Project. Fixed sinking fund payments commenced on June 15, 1978 for Series A Bonds and will commence on June 15, 1979 for Series B Bonds at a rate sufficient to retire in each year $4^1/_2$% (being $2,767,500 annually) of the total bond issue of $61,500,000.

7. Deferred liabilities

(a) Suffield

Rights to the Suffield Block were acquired for $54,000,000 of which $24,000,000 has been paid and the balance is payable in three annual instalments of $10,000,000 commencing one year after recovery of certain expenditures.

(b) Primrose

AEC acquired rights to the Primrose Range for $57,600,000 including $32,000,000 in work obligations. AEC paid $5,158,000 in 1978 for leases to approximately one-fifth of the Range and the balance of $20,442,000 is payable when AEC requests leases to the remaining portions of the Range. Certain work obligations with respect to that part of the Range currently leased have been farmed out.

8. Share capital

(a) Changes in outstanding shares during the year were as follows:

	1978		1977	
	Number of Shares	**Net Proceeds**	Number of Shares	Net Proceeds
Issued for cash	**23,500**	**$ 353,045**	25,500	$ 306,275
Redeemed for cancellation	**2,625**	**28,192**	3,500	37,590
Net increase in the year	**20,875**	**324,853**	22,000	268,685
Share capital — beginning of year	**15,090,976**	**147,344,348**	15,068,976	147,075,663
Share capital — end of year	**15,111,851**	**$147,669,201**	15,090,976	$147,344,348

(b) At December 31, 1978, 27,036 shares (1977 — 25,536) are reserved for issuance under the Share Purchase Plan.

(c) Pursuant to the AEC Act only citizens or residents of Canada are eligible to purchase, own or hold AEC shares. In addition, the maximum ownership of any one shareholder, excluding the Province of Alberta, is limited to 1% of the total number of issued and outstanding shares of the Company.

9. Supplementary information to statement of earnings

(a) Revenues and depletion, depreciation and amortization

	Gross operating revenue (net of royalties) ($000's)		Depletion, depreciation and amortization ($000's)	
	1978	1977	**1978**	1977
Gas and oil	**$28,177**	$14,951	**$ 4,920**	$3,002
Pipelines	**11,891**	—	**2,309**	47
Forestry	**9,004**	4,774	**919**	769
Coal	**4,256**	—	**531**	—
Other	**1,452**	553	**580**	132
	$54,780	$20,278	**$9,259**	$3,950

(b) Interest (expense) income — net

This includes interest on long-term debt of $6,473,000 (1977 — $2,371,000) of which $1,552,000 (1977 — $2,371,000) representing interest incurred during construction has been capitalized as property, plant and equipment.

(c) Joint ventures

AEC is a participant in certain joint ventures as outlined in Note 1(a). Joint ventures are accounted for by the proportionate consolidation method and accordingly AEC has included in its accounts the following aggregate amounts in respect of such investments.

	1978	1977
Assets	**$57,936,754**	$45,600,437
Liabilities	**2,819,220**	4,534,285
Gross operating revenue	**14,832,526**	4,902,790
Expenses	**13,263,186**	5,788,486

10. Remuneration of directors and senior officers

The aggregate direct remuneration paid by AEC and its subsidiaries to its directors as directors was $63,000 (1977 — $48,000) and to its senior officers as officers $483,000 (1977 — $352,000).

11. Contingent liabilities

(a) The Company is one of four defendants in a legal action claiming general and special damages totalling $7.7 million, arising from the awarding of contracts for the construction of two pipelines to serve the Syncrude project.

(b) The Company is one of several defendants in a legal action commenced by a minority shareholder of Willowglen claiming damages totalling approximately $5.5 million.

According to counsel no estimates of the outcome or the liabilities, if any, can be given and accordingly no provisions have been made in the financial statements for the liabilities, if any, of the Company in connection with these actions.

12. Syncrude option

AEC has an option expiring September 1, 1979 to purchase an interest of not less than 5% nor greater than 20% in the Syncrude Project. Should AEC exercise this option, the cost of each 1% interest is estimated to be approximately $25 - $30 million.

FOUR YEAR REVIEW

	1978	1977	1976	1975
FINANCIAL				
Gross operating revenue (net of royalties)	**$ 54,780,000**	$ 20,278,000	$ 1,296,000	—
Equity in earnings of affiliates	**$ 5,213,000**	4,670,000	2,776,000	285,000
Net earnings	**$ 18,786,000**	14,857,000	8,460,000	3,981,000
Net earnings per common share	**$ 1.24**	0.98	0.56	0.52
Cash flow	**$ 30,493,000**	17,112,000	8,263,000	3,718,000
Cash flow per common share	**$ 2.02**	1.13	0.55	0.49
Shareholders equity per common share	**$ 12.80**	11.56	10.57	10.00
Working capital	**$141,033,000**	15,495,000	68,377,000	123,073,000
Investments in property, plant and equipment	**$ 90,634,000**	109,020,000	38,017,000	59,722,000
Long-term debt	**$209,216,000**	44,558,000	—	—
Total assets	**$504,139,000**	273,291,000	216,419,000	195,988,000
SHARE DATA				
Number of shareholders	**53,292**	54,169	56,394	62,385
Common shares outstanding	**15,111,851**	15,090,976	15,068,976	15,062,064
Volume of shares traded	**1,847,690**	1,795,341	2,556,006	35,576
Share price range	**$19.75 - 14.63**	19.25 - 11.75	12.25 - 8.50	10.25 - 9.75
GAS AND OIL				
Wells drilled	**397**	301	216	—
Acres under lease, military blocks	**1,889,800**	614,600	614,600	614,600
Revenue from gas and oil (net of royalties)	**$ 28,177,000**	14,951,000	618,000	—
Gas and oil royalties paid	**$ 13,607,000**	7,600,000	282,000	—

BOARD OF DIRECTORS

MATHEW M. BALDWIN
Company Director
Edmonton, Alberta

EDWARD A. GALVIN
President
Poco Oil Ltd.
Calgary, Alberta

M. EARL LOMAS, Q.C.
Partner, Macleod Dixon
Barristers and Solicitors
Calgary, Alberta

PETER L. P. MACDONNELL, Q.C.
Partner, Milner & Steer
Barristers and Solicitors
Edmonton, Alberta

JOHN E. MAYBIN
Chairman of the Board
Canadian Utilities Limited
Toronto, Ontario

STANLEY A. MILNER
President
Chieftain Development Co. Ltd.
Edmonton, Alberta

DAVID E. MITCHELL
President and Chief Executive Officer
Alberta Energy Company Ltd.
Calgary, Alberta

RAYMOND J. NELSON
President
Nelson Lumber Company Ltd.
Lloydminster, Alberta

GORDON H. SISSONS
President, I-XL Industries Ltd.
Medicine Hat, Alberta

J. HARRY TIMS
President and General Manager
McTavish McKay & Company Limited
Calgary, Alberta

OFFICERS AND SENIOR PERSONNEL

DAVID E. MITCHELL
President and Chief Executive Officer

NICHOLAS J. LASHUK
Executive Vice-President

FLOYD D. AARING
Vice-President

GWYN MORGAN
Vice-President,
Gas and Oil

JACK G. ARMSTRONG
Senior Vice-President, Finance

LORNE A. CARRIER
Vice-President and Comptroller

JOHN D. WATSON
Treasurer

KENNETH R. KING
Senior Vice-President

ARLENE J. MOORE
Corporate Secretary

KATHLEEN D. KRAUS
Assistant Corporate Secretary

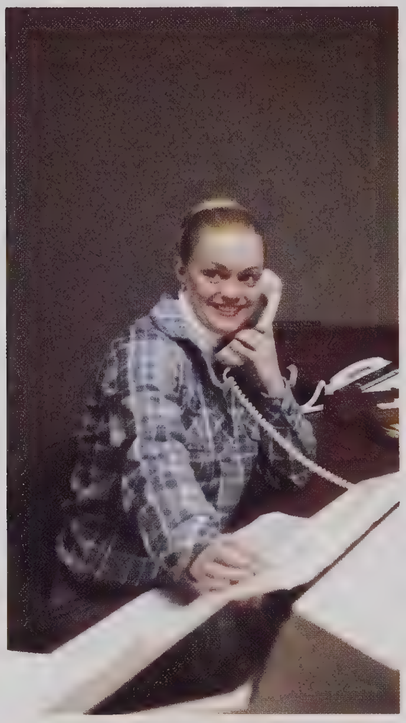
FRANK W. PROTO
Administration and
Personnel

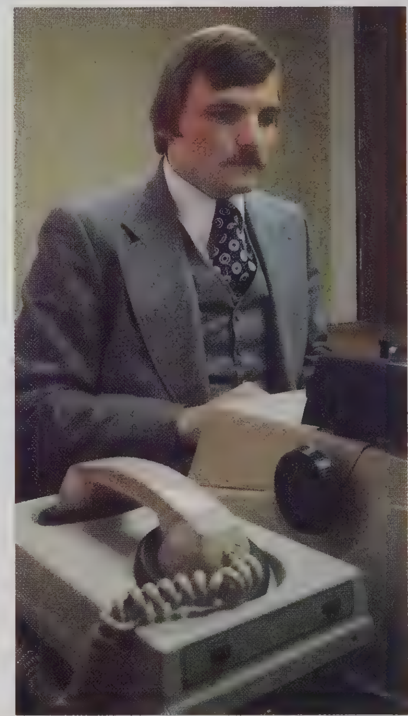
ROBERT W. HAYES
General Counsel

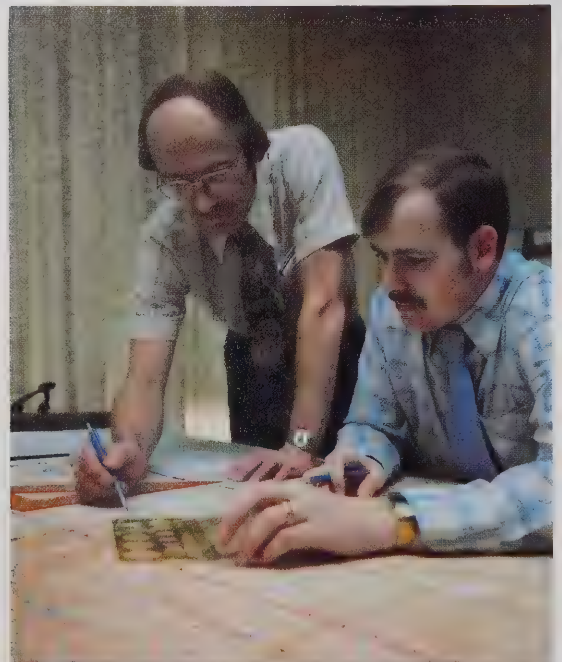
ROGER D. DUNN
Vice-President,
AEC Coal

EDWARD R. ALEXANDER — Manager, Business Development
JOHN F. BOESSENKOOL — Manager, Accounting
DEREK S. BWINT — Manager, Financial Evaluations
JACK E. ELLEFSON — Manager, Alberta Oil Sands Pipeline
HECTOR J. McFADYEN — Manager, Economics

AEC PEOPLE AT WORK







CORPORATE INFORMATION

Head Office
#1100
10621 - 100 Avenue
Edmonton, Alberta
T5J 0B3

Calgary Office
#2400
639 - Fifth Avenue S.W.
Calgary, Alberta
T2P 0M9

REGISTRAR

National Trust Company, Limited
Edmonton, Alberta

TRANSFER AGENTS

National Trust Company, Limited
Edmonton, Calgary, Vancouver, Winnipeg, Toronto, Montreal; and its agent,
Canada Permanent Trust Company in Regina

STOCK EXCHANGE LISTINGS

Alberta Stock Exchange
Montreal Stock Exchange
Toronto Stock Exchange
Vancouver Stock Exchange

AUDITORS

Price Waterhouse & Co.
Chartered Accountants
Edmonton, Alberta

SUBSIDIARIES

Alberta Oil Sands Pipeline Ltd. — 100%
AEC Heavy Oil Ltd. — 100%
Alberta Industrial Gas Suppliers, Ltd. — 100%
AEC Coal Company Ltd. — 100%
Willowglen Company Limited — 76%

AFFILIATES

AEC Power Ltd. — 66⅔%
Pan-Alberta Gas Ltd. — 50%
Steel Alberta Ltd. — 50%

JOINT VENTURES

Coal Valley Project — 25%
Ethane Gathering System — 33⅓%
Whitecourt Forestry Complex — 40%

ANNUAL MEETING

The annual general meeting of shareholders of Alberta Energy Company Ltd. will be held in the Canadian Room at 5411 - 44th Street in Lloydminster at 3:00 p.m. local time on Tuesday, April 17, 1979.

Copies of the Company's 1978 Annual Report may be obtained by contacting the office of the Secretary of the Company at Alberta Energy Company Ltd., #2400, 639 Fifth Avenue S.W., Calgary, Alberta T2P 0M9

PRINTED IN ALBERTA

Alberta Energy Company Ltd.

1978 Annual Report

AN ALBERTA-BASED COMPANY
WITH MORE THAN 50,000
CANADIAN SHAREHOLDERS

Alberta Energy Company Ltd.

INTERIM REPORT

FOR THE SIX MONTHS ENDED JUNE 30, 1978

ALBERTA ENERGY COMPANY LTD.

. . . an Alberta-based Company with more than 50,000 Canadian shareholders.

#1100 10621 - 100 Avenue, Edmonton, Alberta T5J 0B3
#2400 639 - 5 Ave. S.W., Calgary, Alberta T2P 0M9

REPORT TO SHAREHOLDERS
HIGHLIGHTS

- Six-month net earnings after taxes were $8,517,000 or 56¢ per share, 19% higher than for the same period last year.
- Cash flow was $11,686,000 which is 29% above the comparable period in 1977.
- Gas production averaged 72 million cubic feet per day and oil production 325 barrels per day.
- The petroleum and natural gas rights underlying 2,000 square miles of Primrose were acquired for a total commitment of $57.6 million.
- Long-term debt financings for construction of AEC Power's Utilities Plant and the Alberta Oil Sands Pipeline, totalling $297 million, have been successfully completed.
- Coal Valley facilities have been completed and coal sales have commenced.
- Petrochemicals Alberta Project (PETALTA) has obtained an Industrial Development Permit to build a world-scale benzene plant.
- Recently-announced royalty reductions on low-productivity shallow gas wells are expected to have significant favorable impact on Suffield revenue.

FINANCIAL REVIEW

The Company's net earnings and cash flow for the first six months of 1978 increased over the comparable period in 1977. Net earnings after provision for deferred income taxes were $8,517,000 or 56¢ per share, an increase of 19%. Cash flow to mid-year was $11,686,000 or 77¢ per share, 29% higher than for the same period of the previous year.

AEC is a rapidly growing company making large capital investments in a number of projects. At mid-year, approximately $95 million of its property, plant and equipment is under active development; revenue from these will add to earnings in the future.

During the first half of the year, revenue increased due to additional sales of gas and forest products. AEC also received, for the first time, cash revenue from the Alberta Oil Sands Pipeline and the ethane gathering system.

ALBERTA ENE

CONSOLIDATED S

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Income from Operations*
Gas and Oil ....
Forestry ....
Pipelines ....
Other ....
Interest on Short-Term Investments....

General and Administrative Expenses ....
Income Before Taxes and Equity Earnings ....
Provision for Deferred Income Taxes ....

Equity in Earnings of Affiliates ....
Allowance on Equity Funds Employed During Con
Net Earnings ....
Earnings per Share ....

** Revenue before Operating Costs, Depreciation and Deple*
$4,579,000 (1977 — $1,917,000); Pipeline $2,021,000; Other

CONSOLIDATED STATEMENT C

(U

Source of Funds:
Income before taxes and equity earnings ....
Non-cash items, principally depletion and dep
Funds from operations ....
Issue of share capital ....
Issue of long-term debt ....
Deferred liability ....

Use of Funds:
Investment in property, plant and equipment
Gas and Oil ....
Pipelines ....
Coal ....
Forestry ....
Other ....

Repayment of production advances ....
Reduction in long-term debt ....
Increase in other assets and deferred charges .

Decrease in Working Capital ....
Working Capital — Beginning of Period ....
Working Capital — End of Period ....

Y COMPANY LTD.

EMENT OF EARNINGS
dited)

	1978	1977
	Six Months Ended June 30 (In Thousands)	
.....	$ 8,980	$ 5,783
.....	401	(494)
.....	1,478	
.....	(861)	
.....	737	3,155
	10,735	8,444
.....	2,053	1,377
.....	8,682	7,067
.....	3,428	2,711
	5,254	4,356
.....	2,249	1,742
ction	1,014	1,017
.....	$ 8,517	$ 7,115
.....	56¢	47¢

was — Gas and Oil $12,934,000 (1977 — $7,889,000); Forestry
,000

HANGES IN FINANCIAL POSITION
dited)

	1978	1977
	Six Months Ended June 30 (In Thousands)	
.....	$ 8,682	$ 7,067
ation	3,004	2,001
.....	11,686	9,068
.....	263	207
.....	16,257	30,000
.....	25,600	
	53,806	39,275
.....	42,576	15,957
.....	7,229	25,450
.....	3,403	12,537
.....	643	1,244
.....	818	101
	54,669	55,289
.....	762	397
.....	2,700	
.....	1,394	610
	59,525	56,296
.....	5,719	17,021
.....	15,495	67,985
.....	$ 9,776	$50,964

PRIMROSE

In April, AEC acquired for a total commitment of $57.6 million the petroleum and natural gas rights underlying another large block of military acreage in Alberta. This block is the Primrose Lake Air Weapons Range located north of Cold Lake, Alberta, straddling the Alberta-Saskatchewan border. The Company acquired the rights underlying the Alberta portion of the Range, which encompasses approximately 2,000 square miles, or about one and one-quarter million acres. The Company also acquired an option to develop the forestry rights on the Range.

Surface access negotiations with the Department of National Defence are now under way. AEC's experience and performance at Suffield will assist it in obtaining surface access at Primrose in a manner that will permit the development of these Canadian energy resources while military operations continue.

AEC believes the Primrose Range has potential for both natural gas and oil development. Proposals will be invited from industry for evaluation and development of these resources.

SUFFIELD

A high level of activity continues on the Suffield Block, with approximately 650 square miles or 65 percent of the 1,000-square-mile Block now on production or under active development.

Drilling operations and the construction of compressor stations and related gathering facilities are in progress in Areas "B", "C" and "D". The initial development program has been completed in Area "A" and in the eastern portion of the Koomati area.

One hundred and thirty-seven shallow gas wells were drilled in the shallow drilling program during the first six months of 1978, bringing the total at mid-year to 688.

Production to mid-year averaged 72 million cubic feet of gas per day and 325 barrels of oil per day.

AEC has negotiated early surface access to an additional 43,000 acres located in the southwestern and eastern portions of the Block. This will allow AEC to further accelerate its shallow gas drilling program and thus shorten the time it will take to develop the entire Block.

The deep drilling programs in the northeastern and southeastern areas of the Block have commenced, with 47 deep wells having been drilled to mid-year. Eleven of these wells have been cased as potential producers. Three of the 11 are gas wells, 6 are heavy oil wells and 2 are multi-zone oil wells.

Recently, the Alberta government announced a scheme under which low-productivity gas wells will pay a reduced royalty. Details of the new royalty structure are not yet established, but it appears that the Company's wells in Suffield will benefit. The royalties to be paid on gas production commencing August 1, 1978, will be reduced, thus increasing the earnings being realized from the sale of shallow gas.

AEC has long-term, take-or-pay gas sales contracts at Suffield for the sale of all of the shallow gas and deep gas developed to date and all of the shallow gas expected to be developed over the next several years. The current oversupply of gas makes these sales contracts particularly beneficial to the Company.

AEC POWER LTD.

The $262 million Syncrude Utilities Plant owned by AEC Power Ltd. is now fully constructed and is being operated by Syncrude. The plant is supplying the steam, electric power and process water required to operate the entire Syncrude project.

AEC Power Ltd. completed the sale of a $55 million United States dollar series of 8⅝% First Mortgage Bonds in June. This issue, negotiated a year ago when interest rates were lower, yielded $60.8 million in Canadian funds and completed the financing of the Utilities Plant.

Cash revenue is now being received for the first time from the Utilities Plant.

ALBERTA OIL SANDS PIPELINE LTD.

The Alberta Oil Sands Pipeline has commenced the transportation of oil from the Syncrude plant at Ft. McMurray to Edmonton.

All financing arrangements with respect to the pipeline have been completed, and a rate of return on the equity portion of the capital cost of the pipeline has been established with the Syncrude Participants.

ETHANE GATHERING SYSTEM

Construction of the 400-mile-long ethane gathering system, owned one-third by AEC, has been completed and ethane transportation has commenced.

During the first half of the year, this pipeline moved a total of 2 million barrels of ethane.

COAL

Construction of facilities required to mine, clean, and load 2.5 million tons of coal annually was completed at Coal Valley during the first half of the year.

The mine is now fully operational and employs about 250 people.

In June, the first unit train loaded with clean thermal coal left the mine site marking the commencement of coal sales.

OTHER ACTIVITIES

Forestry — During the first six months of 1978, the Whitecourt lumber manufacturing plant at Blue Ridge achieved its design capacity of 440,000 board feet per day.

Now that the lumber manufacturing plant is fully operational the second phase of the planned three-phase development program, the glued products plant, is being evaluated.

Petrochemicals Alberta Project — PETALTA recently obtained an Industrial Development Permit to build a 1.1 billion-pounds-per year benzene plant.

This important milestone has enabled the Participants in the project to proceed further with project planning and marketing arrangements for benzene and the co-products of benzene manufacture.

The PETALTA consortium is now able to actively seek an additional working-interest partner with experience in the aromatics or petrochemicals industries.

Steel Alberta Ltd. — During the first six months of the year, this AEC affiliate acquired the rights to two iron ore deposits containing in excess of one billion tons of proven and probable reserves. One of these deposits is located in Alberta and the other in Montana.

Syncrude Option — The Company is continuing to evaluate its option to purchase between 5 percent and 20 percent of the Syncrude project. The total initial investment could range from $125 million to $500 million. A decision regarding this investment will likely be made early in 1979.

David E. Mitchell
President

June 30, 1978